

# Role and Performance Evaluation of NFRA as Independent Regulator - A Case Departing Power or Conflict with ICAI

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## ABSTRACT

The National Financial Reporting Authority (NFRA) constituted on 01 October 2018 under section 132 of the Companies Act, 2013 with the objective of constituting independent regulator for the auditing function to improve the transparency and reliability of the financial statements. The ICAI is set up under the The Institute of Chartered Accountant Act 1949 with the entrusted task of formulating accounting and auditing standards in India. The objective of the paper to examine the role and performance of NFRA in the light of the presence of ICAI as existing monitoring body of accounting and auditing profession. The paper analysed the cases and reports submitted in the recent past by both the regulatory body. The gross violations of the accounting and auditing standards reported by NFRA are the eye opener. The paper concludes that the two body should work together to evolve improving quality of accounting and auditing standards in practice in India. The judgment of the Hon'ble Supreme Court of India in S.Sukumar VS The secretary, also emphasized an independent body to regulate and oversee the profession in the best interest of the resources and current global practices.

**Keywords--** The National Financial Reporting Authority (NFRA), The Institute of Chartered Accountant of India, Ind AS, Auditing Standard, Accounting Standards, Companies Act 2013

On the same lines the NFRA Rules 2018 also provides the scope of work. The NFRA was also given the power to investigate into the matter of professional or other misconduct by the chartered accountants. It is vested with the same power as in a civil court under the Code of Civil Procedure, 1908. The body can impose monetary penalty on the chartered accountants and the firms of chartered accountants and can even debar the chartered accountants/firm to be appointed as an auditor or other professional work for any company.

The need of NFRA was outlined with the following failures

1. The failure of the Institute of Chartered Accountant of India (ICAI) as self-regulatory body on the basis of argument of violation of Chartered Accountant Act, 1949, Code of conduct laid down by ICAI, Companies Act, FEMA, RBI circulars and other allied laws.
2. Scam like failure of Yes Bank, DHFL, Satyam, Global Trust Bank and UB Group (Kingfisher Airline) due to non-performance of the auditor and the regulator.
3. The questionable role of multinational accounting firms (MAF) operating in India and the nexus between Indian accounting firms and multinational accounting firms to solicit audit and assurance work grossly violating the laws of the land and code of ethics.
4. The high powered committee expert group report dated 29<sup>th</sup> July 2011 highlighted the operation of MAF violating the laws permission granted by the government of India.
5. The Hon'ble Supreme Court of India judgment in civil appeal no. 2422 of 2018 S.Sukumar VS The secretary, The ICAI and others issued directions to set up committee on the violation of CA Act, RBI Act, FEMA Act etc and observed ICAI to play proactive role for upholding ethics and values of the profession, examination and investigation by the government agencies, enactment of law in line with Sarbanse Oxley Act in U.S. requiring corporate leaders to personally

## I. INTRODUCTION AND RATIONALITY

With the mandate given to the National Financial Reporting Authority (NFRA) under section 132 of the Companies Act 2013 in 2018 it was to

- (a) To make recommendation to the Central Government on the formulation and laying down of accounting and auditing policies and standards for adoption by companies and auditors
- (b) Monitoring the compliance with accounting and auditing standards in force
- (c) Oversee the quality of service of the professionals.

certify the accuracy of their company's financials.

## II. LITERATURE REVIEW

There are not many studies which are directly researching the working of the ICAI and NFRA. Amresh, V. (2018) reported that the ICAI's disciplinary mechanism out of the 1,972 cases taken up only in the matter relating to Satyam Computers have the members been permanently removed. Penalties of one year or more have been imposed on members in only 14 of these cases. In large number of the cases, the members have been found as not guilty. In other majority of the cases where members have been found guilty, they have been merely reprimanded or cautioned. Gupta and Gupta (2015) found that the regulatory system is weak, and there is dire need to redefine the role of auditors. Coordination among different regulatory authorities is poor, and after every scam, there is a blame game. Reporting of fraud and publication of fraud prevention policy are missing. Banks and financial institutions are ineffective on due diligence, and there is a lack of professionalism on the board and other executive levels in companies. Menon, H. (2017) suggested that there should be true adoption of international financial reporting standards and more emphasis on enforcement of new regulatory paradigm. Sushila (2019) found that NFRA is constituted due to failures of ICAI on the regulation of the irregularities of accounting and auditing profession. It further concludes that the ICAI has failed to take action against the chartered accountant promptly who were involved in the reporting related scams in India. Karanth, S. & Srinivas, K.T. (2020) found that the impact of NFRA is not visible after its establishments and there are many regulatory authority already in place in India and by creating NFRA, the government has made the structure more complex and multi-layer. It suggested that government should have created separate independent regulatory body under the surveillance of ICAI so that autonomy of ICAI would have retained. Yadav, H. (2022) found that scandals and frauds arises when directors and top management are not forced to follow certain governance code. The focus should shift from only investor protection to all stakeholders' protection. It further concludes that a better compliance mechanism by regulatory bodies is not sufficient. Therefore there is need to judge the performance of the regulatory body from time to time instead of financing a corporate fraud by the government exchequer or state mechanism interferes and forces other institutions to correct the wrong doing of a corporate failures.

## III. OBJECTIVES

The underline objective is to study the role of NFRA in the presence of The Institute of Chartered Accountants of India. The study of the reports of NFRAs issued. The evaluation of monitoring and oversight function of the NFRA vis a vis ICAI.

## IV. ANALYSIS

### 4.1 The National Financial Reporting Authority of India

In the pursuit of the entrusted task the NFRA has issued audit quality report and financial reporting quality reports.

#### *Audit Quality Review Report (AQRs)*

The audit quality report is the assessment and evaluation of the quality of the audit undertaken by the chartered accountants. The following are worth mentioning

- (1) statutory audit of Jaiprakash Associate Ltd for the financial 2017-18, the report underlines the following shortcoming in the functioning of the auditor
  - (a) Material and pervasive impact on profits were not reported by the audit
  - (b) Insufficient audit evidences
  - (c) Incomplete audit procedures
  - (d) No reporting of the non compliances of the accounting standards and standards on auditing
  - (e) Failure to assess the basis accounting and fundamental principle i.e. going concern
  - (f) Gross negligence in maintaining proper documentation of the statutory audit
- (2) Statutory Audit of IL&FS Transportation Network Ltd for the financial year 2017-18. Following violation were reported
  - (a) The appointment of the statutory auditor was illegal and void.
  - (b) Failed to assess the basic accounting principle of going concern.
  - (c) Serious violation of Ind AS and SAs.
  - (d) Improper valuation of investment and understatement of losses
  - (e) Failure to report material misstatement
  - (f) failed to maintain required documents as per SA and the integrity is questionable.

#### *Financial Reporting Quality Review Reports (FRQRs)*

The said reports highlight the divergence and non-compliance form Ind-AS and other GAAP in the financial statement prepared by the company of which Board Directors has the responsibility.

- (1) The high impact items in FQRs of KIOCL Ltd for the year 2019-20 revealed.

- (a) The erroneous accounting policy material element i.e. revenue which raises the question over reliability and accuracy of the financial statement.
  - (b) Non-compliance of accounting standards such as Ind As 36, Impairment of Asset and erroneous complaint of accounting standard such as Ind As 109 Financial Instruments.
  - (c) NFRA recommends the restatement of financial statement following Ind AS 8 Accounting Policies, Changes in accounting estimates and Errors and section 131 of Companies Act Voluntary revision of financial statement.
- (2) The high impact items in FQRRs of Prabhu Steel Industries Ltd for the financial year 2019-20 revealed
- (a) Violation of Companies Act 2013 regarding the preparation and presentation of the financial statements.
  - (b) Contradictory disclosures in the Board report.
  - (c) Failed to present the statement of changes in Equity in the financial statements, therefore violation of Companies Act 2013 and Ind AS 1
  - (d) Failed to comply key requirements of Ind AS on financial instruments and fair measurement.
  - (e) Failed to make appropriate disclosures as required by Schedule III to Companies Act regarding its borrowings and loans given.

In follow up of the above pervasive errors/omission the company agreed to prepare and publish restated financial statements.

Apart from publishing two reports on audit quality and financial reporting the NFRA also endeavored for the professional standards and quality management. The NFRA advised the ICAI review the entire set of auditing pronouncements to address issued pointed out and Submit the amendments for NFRA's review and recommendation to Ministry of Corporate Affairs. It also suggested the Institute of Chartered Accountant of India the revision of standards applicable for Micro, Small and Medium size companies in line with the IFRS standards. The NFRA also strongly make case for amendment in Ind AS in convergence with high quality globally accepted IFRS.

#### **Whistle Blower Confidentiality**

NFRA has also issued guidelines on procedure for Complaint handling in NFRA and dedicated channel, in the name of <https://nfracoms.nic.in/> for online submission of

complaints. Special procedure has also been devised for handling complaints from whistle blowers where the complainant requests to keep his name and contact details confidential.

#### **4.2 The Institute of Chartered Accountant of India**

The Institute of Chartered Accountants of India (ICAI) is a statutory body established by The Chartered Accountants Act, 1949 for regulating the profession of Chartered Accountancy in India. As the premier accounting body, the ICAI has delivered to the world high class CA professionals apart from setting benchmarks in the quality of financial reporting not only in India but across the Globe. It formulates the accounting and auditing standards to be implemented by the companies and the concerned auditors. It monitors the profession and ensure the ethical standards to be adopted by its members. It takes the disciplinary action against the erring member and make recommendation to the government. This is the self-regulatory body until the formation of NFRA. It has been the general perception among the chartered accountants that what was the need of forming another body when the institute is already into its course of action. The disciplinary mechanism of ICAI has following three important parts

- (1) Director (Discipline): The director is appointed under section 21 of The Chartered Accountant Act as head of the disciplinary directorate to investigate the complaint against the chartered accountant.
- (2) Board of Discipline: The board of discipline is constituted under section 21A of The Chartered Accountant Act to deal with the cases of professional and or other misconduct falling within the ambit of the first schedule of The Chartered Accountant Act.
- (3) Disciplinary Committee: The disciplinary committee is constituted under section 21 B of The Chartered Accountant Act to deal with the cases of professional and or other misconduct falling within the ambit of the second schedule or both the schedules of The Chartered Accountant Act.

This disciplinary mechanism operating at ICAI has from time to time taken action in the form of fine or reprimanding or debarring the chartered accountant held guilty of professional and other misconduct.

## **V. CONCLUSION**

There is been saying that the self-regulation is not the best way to regulate the indiscipline and misconduct on the part of the professional institution set up under an Act in India. So then question looms over that ICAI and NAFRA are the two parallel institution to regulate and

oversee the accounting and auditing profession in India. The Ministry of Corporate Affairs made clear that the two have different jurisdiction. The two have different roles and areas of functioning. The cases of gross violation of accounting and auditing standards published by NFRA are the eye opener. The very basic accounting principles if gets violated which is resulting the corporate fraud like satyam, DHFL etc It seems NFRA sometimes does not connect with the ICAI before coming out with its reports. The two needs to communicate with positive approach to focus more on improving quality of accounting and auditing standards in practice in India. It is hard truth that there is need of an independent body to regulate and oversee the profession in the best interest of the resources and current global practices. The judgment of the Hon'ble Supreme Court of India also indicating and suggesting the same. The paper suggests the NFRA, ICAI and Ministry of Corporate Affairs, Government of India to work in coordination and in consultation with each other so that future corporate scams can be prevented.

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